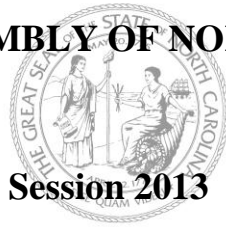


# GENERAL ASSEMBLY OF NORTH CAROLINA



## FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

**DATE:** 02/13/2013

**TO:** Senate Finance Committee

**FROM:** Patrick McHugh and Jennifer Hoffmann  
Fiscal Research Division

**RE:** PCS to SB 76

### FISCAL IMPACT

(\$ in millions)

☐ Yes      ☐ No      ☒ No Estimate Available

State Impact	FY 2013-14	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18
General Fund Revenues:	not available	not available	not available	not available	not available
General Fund Expenditures*	0.2	0.2	0.2	0.2	0.2
Special Fund Revenues:*					
Special Fund Expenditures:					
State Positions:					
<b>NET STATE IMPACT</b>	<b>Not Available</b>	<b>Not Available</b>	<b>Not Available</b>	<b>Not Available</b>	<b>Not Available</b>

\* Section 6 of the PCS also appropriates \$22,900 from the Mineral Interest Fund to DENR for the 2012-13 fiscal year to be used for expenses related to the Commission's implementation of legislative directives.

**PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED:** The Departments of Environment and Natural Resources, Commerce and Revenue. Also affected are the Community Colleges System Office, the University of North Carolina, the Department of Transportation and the State Ports.

**EFFECTIVE DATE** March 1, 2015

**TECHNICAL CONSIDERATIONS:** None

**BILL SUMMARY:** The Proposed Committee Substitute (PCS) for Senate Bill 76 would modify provisions related to oil and gas exploration and development activities in the State, including the

use of horizontal drilling and hydraulic fracturing treatments for that purpose; impose a tax for the severance of energy minerals from the soil or water of the State and make associated changes; appropriate monies to the Department of Environment and Natural Resources to operate the Mining and Energy Commission and for related expenditures; assign future revenue from offshore energy production; encourage the Governor to develop a regional compact for offshore energy exploration; amend the Energy Policy Act (renamed as the Energy Policy and Jobs Act) and the Energy Policy Council (reconstituted as the Energy Jobs Council); and direct the Medical Care Commission to adopt rules authorizing facilities licensed by the Department of Health and Human Services to use compressed natural gas as an emergency fuel.

## **ASSUMPTIONS AND METHODOLOGY:**

**Section 1(a) and (b):** Repeals the prohibition of the issuance of permits for oil and gas exploration using horizontal drilling and hydraulic fracturing treatments in the State that was imposed in Section 3.(d) of S.L. 2012-143, and authorizes the Department of Environment and Natural Resources (DENR) to issue such permits effective March 1, 2015.

No Fiscal Estimate Available: The North Carolina Mining and Energy Commission (MEC) has been charged with developing a modern regulatory program for the management of oil and gas exploration and development activities in North Carolina, including the use of horizontal drilling and hydraulic fracturing. The MEC has been meeting since September 2012 to develop the rules necessary for issuance of permits for horizontal drilling and hydraulic fracturing. According to DENR, until these rules are formalized, they cannot estimate the amount of time necessary to review and approve such permits and conduct the compliance and enforcement activities associated with the permits. Further, because North Carolina is a relative newcomer to this field, DENR does not know the number of entities that may be seeking these permits. Without knowing what the rules will say or the number of entities interested in seeking permits for oil and gas exploration, DENR was unable to provide a fiscal estimate.

**Section 1.(c):** Requires the Mining and Energy Commission, with assistance from DENR, to study the development of a coordinated permitting program for oil and gas exploration and development activities using horizontal drilling and hydraulic fracturing to develop a single comprehensive environmental permit to govern well construction, siting, and closure requirements; hydraulic fracturing treatments; water quality and management of water resources; management of waste and regulation of air emissions.

No Fiscal impact: The study places additional responsibilities on the MEC to explore the development of a comprehensive environmental permit. DENR received a recurring appropriation of \$250,000 and 3 staff positions in FY 2012-13 to provide staff to the Commission. According to DENR, the MEC is already intending to create such a permitting program to the extent allowable by federal law and as a result no additional staff will be necessary to complete the study.

**Section 2.(a):** Amends the composition of the Energy Mining Commission by reducing the number of members from 15 to 13.

No Fiscal impact: There is no fiscal impact of reducing the Commission membership by two. The Commission has met five times since it was established in August 2012. Fourteen members attended the first three meetings, 12 attended the fourth meeting and 11 attended the fifth meeting. There are currently two vacancies on the Commission.

**Section 3.(a):** Amends existing law that requires the MEC to limit the total amount of oil and gas produced in the State if the total amount produced exceeds the amount reasonably required to meet market demand and instead authorizes the Commission to determine the amount (an “allowable”) of oil that may be produced in the state.

No Fiscal Impact. Under existing law, the Mining and Energy Commission is already tasked when determining the “allowable.”

**Section 3.(b):** Repeals the requirement for the Department of Environment and Natural Resources, in consultation with the Consumer Protection Division of North Carolina Department of Justice, to establish and maintain a registry of landmen operating in the State.

No fiscal impact.

**Section 4:** Amends existing law to exempt “fluid associated with exploration, production, or development of natural gas resources” from the prohibition of discharging any wastes to subsurface or groundwater of the State by means of wells.

No fiscal impact.

**Section 5:** Repeals North Carolina’s current severance tax and levies a new severance tax on the removal of energy minerals from the soil and water of the State. The new severance tax would add condensates to the tax base, raise the tax rate on oil, and create a floating tax rate for gas.

The revenue generated by the severance tax would be allocated in the following manner:

- First 25%, up to \$1 million each year allocated to DENR to administer its duties under Article 27 of Chapter 113 of the Oil and Gas Conservation Act
- Remaining revenue would be allocated in the following manner:
  - 50% to the General Fund
  - 50% to Onshore Emergency Management Fund to reach and maintain a balance of \$10 million. Once the Fund balance is reached, revenues would be directed to the General Fund.

Section 5 also prohibits local governments from imposing any additional taxes on the severance of energy minerals in the State.

No fiscal estimate available: It is not possible to reasonably estimate the fiscal impact of the severance tax to be created by this provision for the following reasons:

- Absence of historical data from North Carolina: While there is potential for natural gas exploration and extraction in North Carolina, there is no historical data on natural gas extraction that could serve as the foundation for a rigorous projection of future activity.
- Uncertain volume of recoverable natural gas in North Carolina: At the current time, substantial uncertainty remains as to the amount of recoverable natural gas in North Carolina. In the absence of proven reserve levels, it is not possible to project the volume of gas that will be extracted in each of the next five years.
- Uncertainty in future price of natural gas driving uncertainty in levels of new exploration: Levels of future exploration is largely determined by the price of natural gas. The price of natural gas has been extremely volatile in recent years. As new extraction technologies have provided access to previously unrecoverable reservoirs, the price of natural gas has declined sharply in last several years. Since hitting a high above \$11 per 1000 cubic feet in mid-2008, natural gas prices have fallen precipitously and stayed below \$5 per 1000 cubic feet since early 2010.<sup>1</sup> Mirroring this decline in prices, the number of natural drilling rigs in operation in the United States has fallen as well. For the week ending on February 1st, 2013 there were 428 natural gas drilling rigs in operation in the United States, down from a high of 1606 in September of 2008.<sup>2</sup> Given recent volatility in the price of natural gas, and the level of natural gas exploration, it is not possible to project the pace at which natural gas exploration and development would proceed in North Carolina over the next five years.

**Section 6:** Appropriates \$22,900 from the Mineral Interest Fund, a special revenue fund in the Department of Environment and Natural Resources, to the Department for the 2012-13 fiscal year to be used to offset expenses of the Mining and Energy Commission related to implementing the legislative mandates of the Commission.

Fiscal impact: Reduces the Mining Interest Fund by \$22,900 and increases the Department's General Fund in a like amount.

**Section 7:** Requires that any revenues or royalties paid to the State from offshore leasing, exploration, development, and production of energy would be deposited in an account to be used for emergency preparation, emergency response, and environmental mitigation associated with the release of liquid hydrocarbons or associated fluids directly related to energy exploration or production. Once this fund reaches \$50 million, any additional revenues or royalties will be directed to the General Fund.

No fiscal estimate available: The licensing of offshore energy production, and the sharing of attendant revenues between the states, is determined by the Federal Government. As there is currently no revenue sharing agreement in place, and it is unclear whether any such agreement will be enacted in the next five years, it is not possible to reasonably project the

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<sup>1</sup> Moody's Analytics. 02/08/13. "Natural Gas: Henry Hub." Accessed at <http://www.economy.com/>

<sup>2</sup> Energy Solutions Inc. 02/01/13. "Natural Gas Drilling Rig Count Statistics: Baker Hughes Weekly Rig Count." Accessed at <http://www.energysolutionsinc.com/naturalgas/Rig-Count-Statistics-29.htm>

revenues that North Carolina could realize from offshore energy exploration and production.

**Section 8:** Encourages the Governor to develop a compact with the governors of Virginia and South Carolina to develop a regional strategy for the exploration of offshore energy resources.

No fiscal impact.

**Section 9:** Amends the “North Carolina Energy Policy Act of 1975” by renaming the Act to the North Carolina Energy Policy and Jobs Act” and by expanding the findings and purpose. Also renames the “Energy Policy Council” to the “Energy Jobs Council,” expands its purposes to include advising on domestic energy exploration, development and production within the State, reduces membership from 16 members to 13, resets of the memberships qualification and terms and transfers the Council from the Department of Commerce to DENR as a Type II transfer. Clarifies that utilities regulated under Chapter 62 of the General Statutes may satisfy the required emergency curtailment plan by submitting the General Load Reduction and System Restoration Plan that is prepared annually for the Utilities Commission. This section makes numerous other changes such as expanding on the types of energy policy on which reports are required as well as reducing the frequency of certain reporting requirements.

Fiscal impact: The Department of Commerce reports that transferring the Energy Policy Council (EPC) to DENR will have no fiscal impact on Commerce’s budget or staff because the EPC has been dormant for at least two years and therefore no time or resources have been devoted to staffing the Council. Any reports required of the EPC have been produced through an Energy Conservation Think Tank outside of state government.

By reconstituting and expanding the duties and responsibilities of Council it is anticipated that the Council will become an active advisory council which will rely upon the Division of Energy, Mineral and Land Resources (DEMLR) to which the Council can delegate its duties when appropriate. Expanded responsibilities include 1) developing a comprehensive State energy policy that addresses effective management and use of present and future sources of energy to include among other things natural gas, coal, hydroelectric power, solar, wind, nuclear energy and biomass; 2) facilitating the expansion of domestic energy supply, 3) actively engaging in discussions with the federal government, its agencies, and its leaders to identify opportunities to increase domestic energy supply with NC and its adjacent offshore waters, and 4) recommending needed energy rule making.

As a result additional staff support is anticipated to staff the Council. DENR suggested that as many as six staff members would be needed to support the work of the Council, the same number the Department requested to staff the MEC. This fiscal note agrees that additional staff expertise will be necessary; however, the department has not submitted sufficient justification to support the need for six new positions. This fiscal note recommends a recurring appropriation of \$200,000 to be provided to DENR so that the DEMLR can provide the necessary expertise to the Council either through permanent positions or a contract for outside expertise. These funds would also support the operating costs of the Council and any necessary research and/or studies.

**Section 10:** Directs the Medical Care Commission adopt a rule to replace the “Electoral Requirement Rule” (10A NCAC 13B .6227(f)(2), “Licensing of Hospitals: Electoral Requirements”), which currently provides that facilities listed by the Department of Health and Human Services must provide emergency electrical to the facilities with fuel that is stored on site in sufficient quantity to provide for not less than 24 hours of operation. This section directs that a rule be created whereby the requirement for emergency electrical would be satisfied by bi-fuel generators that are connected via pipeline to a natural gas utility.

No fiscal impact.

**TECHNICAL CONSIDERATIONS:** None